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CONFIDENTIAL MEMORANDUM

TO: The Ambassador

THROUGH: DCM - Mr. Pascoe

FROM: ECON - Mr. Larucco 2

SUBJECT: Background Briefing Memo for CODEL KUDMAN

Following below are summaries of each section's submission for the background reading material for CODEL RUDMAN. The original informal submissions are attached to this memo.

POLITICAL:

Following a generation of openly hostile confrontation, U.S.-PRC contacts were re-opened in the early 1970's and formally resumed in 1978. Over the last ten years the relationship has steadily progressed in a generally smooth fashion with our political dialogue on regional issues such as Cambodia, the Koreas and Afghanistan an important factor in the progress made on these issues. The tragic events of June 4 and the continuing government crackdown have sent relations into a new era, one which is not yet clearly defined.

While the Chinese government badly wants access to Western technology, capital and markets; they do not want Western cultural or ideological influence. The government has been waging an extensive anti-Western / anti-American campaign which has included suspension of the Peace Corp and Fulbright programs, criticism and jamming of VOA, as well as attacks on the U.S. Congress for interference in internal Chinese affairs. At the same time, due to China's long term economic and strategic interests, we believe China will seek to avoid isolating herself from the U.S. and other Western powers.

MILITARY:

For the better part of the past decade, the U.S. government has engaged in a long-term effort to build friendly relations with China based on mutual strategic and security interests. The relationship is based on three major elements: (1) high level visits, (2) functional military exchanges and (3) military technology cooperation. Following President Bush's announcement on the suspension of the sale and delivery of U.S. defense equipment to China on June 5, the U.S.-PRC military relationship has come to a virtual standstill. In DAO's opinion, even after the Presidential suspensions are lifted, it will require at least several years to rebuild the relationship to a level even approaching that of before June 4th. Our first test, which will

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likely have an impact on the overall Sino-U.S. relationship, comes at the end of this month.

ECONOMIC:

Since the beginning of China's generally successful economic reform program in 1978, Sino-American trade has expanded by a factor of ten to \$14 billion annually and American direct investment in China has grown to over \$3 billion. We are China's third largest trade partner and her second largest source of private capital.

Even before Tiananmen, China faced very serious economic problems including shortages of energy, raw materials, foreign exchange, and consumer goods as well as escalating inflation, rising budget deficits and a widening trade gap. Recent political events and the Western reaction to them have further exacerbated China's problems in attracting foreign aid and investment. Currently pursuing a policy of retrenchment, China's economic policy makers face a difficult task in continuing market and price reforms while still controlling inflation and avoiding stagnation.

COMMERCIAL:

While doing business in China is still a difficult proposition, it has vastly improved since the first American businessmen came here in the late '70's. The most important sign of serious intent to attract foreign investment came in October 1986 with the issuance of the twenty-two Articles on Foreign Investment. Investment conditions continued to improve since that date and there was reason to believe that this trend would continue. However, with the recent resurgence of the conservative wing or "old-guard" political leaders and the return to central planning, many American companies are questioning the future of the China market. This uncertainty combined with serious fundamental economic problems has sent most potential investors to the sidelines to wait for clearer signals.

PRESS AND CULTURAL:

Since its opening in the early '80's, USIA's China program has grown to one of its most important in the world. Prior to the recent turmoil, the Fulbright and International Visitors (IV) programs here were the largest in the world. As noted above, the Chinese have suspended the Fulbright program for this year. Most of the IV candidates have cancelled and the prospect for travel by the remainder is unclear. The Voice of America is a major part of USIA's China program and certainly the most visible program now. Two VOA reporters were expelled from China this summer and most of VOA's Chinese broadcasts continue to be jammed by the Chinese government. It is, however, usually possible to find a clear broadcast among the many frequencies VOA is using. Other important USIA programs in China include an extensive book translation program, a Chinese language quarterly magazine and several exchanges under the U.S.-PRC Cultural Agreement.

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SCIENCE AND TECHNOLOGY:

The principal work of the Science and Technology (S&T) section is the administration of the 1979 Agreement between the U.S. and the PRC on Cooperation in Science and Technology. The detailed agreements on the collaboration in science are contained in some 30 protocols and memoranda of understanding between agencies in the U.S. and China. In general, the exchanges have gone smoothly. The 1989 renewal of the agreement has been complicated by the Omnibus Trade Bill of 1988 which requires all S&T agreements to include an annex on Intellectual Property Rights. Negotiations on this issue proceeded smoothly from November 1988, but broke off following the Tiananmen incident. It appears that the agreement will be extended and a new agreement negotiated. No agency on either side is interested in dropping the agreement.

AGRICULTURAL:

The Foreign Agricultural Service (FAS) program in China consists of agricultural reporting, trade support and promotion and scientific and technical exchanges in the field of agriculture. With the opening of the China market in the late '70's, China became a major market for American agricultural products. However, with the success of China's agricultural reforms, this situation reversed and China became a major exporter. In the last few years, this situation has again reversed and China has become a major market for American products, especially cotton and wheat. Nearly one-third of U.S. exports to China are agricultural; in 1988 U.S. agricultural exports to China totaled \$757 million and forest product exports totaled \$449 million. Recent political events do not seem to have affected these exports to China. FAS's trade promotion program has been seriously affected by lack of American visitors to China and the evacuation of American corporate personnel in China.

CONSULAR:

While some Embassy activities have slowed down as a result of the recent crackdown, the consular section continues to face high demand for visa services. An average of 400-500 Chinese a day seek to apply for non-immigrant visas. Due to staff constraints, only 250 to 300 applications can be reviewed daily. Furthermore, the section has received nearly 250 Congressional inquiries in the last six weeks, compared to 25-30 that they normally receive in that time frame. While there are only about 300 American citizens residing in China today (compared with about 1200 before the evacuation), the consular section is still handling a large number of cases involving assistance to American citizens, most of which are related to recovering property left behind during the evacuation.

ADMIN:

The Embassy's Administrative section has not seen much change in its day-to-day working conditions since June 4. The PRC government has moved quickly to settle all claims involving personal and

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official property damaged in the June 7 PLA firings on the
Diplomatic Compound. The only exceptional occurrence on the
administrative front has been harassment involving bills for the
Voice of America. This does not, however, seem to pose any threat
to continued VOA operation.

drafted: ECUN, RKWILLIAMS

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